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In the
Supreme Court of the United States

OCTOBER TERM, 1958

No. 380

COMMISSIONER OF INTERNAL REVENUE, *Petitioner*

vs.

JOHN R. HANSEN and SHIRLEY G. HANSEN, *Respondents*

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENTS

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Seattle 1, Washington

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INDEX

	Page
Opinions Below	1
Jurisdiction	1
Question Presented	1
Statutes Involved	2
Statement	2
Summary of Argument	7
Argument	10
I. Respondents' Method of Accounting Clearly Reflected Income for Tax Purposes	10
A. The Method and the Issue	10
B. The Statute	11
C. The Accounting Principle—Income Accrues Upon Fixation of Right to Receive	11
D. Respondents Had No Fixed Right and No Claim of Right to Receive Reserve Until GMAC Released It	12
E. Respondents Had No Constructive Receipt	14
F. Each Sale of an Auto on Credit Was a Single Three-Party Transaction, to Which GMAC Was a Necessary Party	15
G. Retail Purchaser Incurred No Account Payable to Respondents: Respondents Acquired No Account Receivable	16
II. Authority Strongly Supports the Unanimous Decision in Favor of Respondents Below	16
III. Basic Fallacies Appear in Petitioner's Argument	19
A. Avoidance of a Contingent Liability Does Not Constitute Income	19
B. All Cases Cannot Be Equated, But Must Be Decided Upon Their Facts	20
C. The "Re-Enactment Doctrine" Is a New Point Not Properly Before This Court	20
D. The Tax Court Rule: Commissioner's Practice	21
Conclusion	22
Appendix	23

CITATIONS

Page

Cases:

Alice State Bank v. Houston Pasture Co., 247 U.S. 240 21

Baird v. Commissioner, 256 F.2d 918 (C.A. 7) cert. granted Nov. 12, 1958, No. 512, Oct. Term, 1958 ..... 9, 17, 20

Ernest G. Beaudry, 1941 P-H B.T.A. Memorandum Decisions, par. 41, 114 22

Commissioner v. Ashland Oil & Refining Co., 99 F.2d 588 (C.A. 6) cert. denied Apr. 17, 1939 15

Commissioner v. Cleveland Trinity Paving Co., 62 F.2d 85 (C.A. 6) 19

Glover v. Commissioner, 253 F.2d 735 (C.A. 8) cert. granted Nov. 10, 1958, No. 381, Oct. Term, 1958 ..... 9, 17

Hansen v. Commissioner, 258 F.2d 585 (C.A. 9) cert. granted Nov. 10, 1958, No. 380, Oct. Term 1958 ..... 8, 9, 13, 14, 16, 20

Helvering v. New Haven & Shore Line Ry. Co., Inc., 121 F.2d 985, cert. denied Feb. 9, 1942 15

Blaine Johnson v. Commissioner, 233 F.2d 952 (C.A. 4) 9, 17

Keasbey & Mattison Co. v. United States, 141 F.2d 163 (C.A. 3) 18

Long Poultry Farms, Inc. v. Commissioner, 249 F.2d 726 (C.A. 4) 7, 13

North American Oil Consolidated v. Burnet, 286 U.S. 417 ..... 7, 11, 12

Schaeffer v. Commissioner, 258 F.2d 861 (C.A. 6) 9, 17, 18

Spring City Foundry Co. v. Commissioner, 292 U.S. 182 ..... 7, 12

Texas Trailercoach, Inc. v. Commissioner, 251 F.2d 395 (C.A. 5) 9, 17

West Pontiac, Inc. v. Commissioner, 247 F.2d 810 (C.A. 5) 9, 17

Statute and Regulations:

	Page
Internal Revenue Code of 1939:	
Sec. 22(a) (26 U.S.C.A. 1952 ed., Sec. 22(a))	2
Sec. 41 (26 U.S.C. 1952 ed., Sec. 41)	2, 7, 11
Sec. 42(a) (26 U.S.C. 1952 ed., Sec. 42(a)	2, 11
G.C.M. 9571, X-2 Cum. Bull. 153	22
Revenue Ruling 57-2, 1957-1 Cum. Bull. 17	22
Treasury Regulation 111:	
Section 29.41-1	7
Section 29.41-2	7
Treasury Regulation 118:	
Section 39.42-2	8, 15

Miscellaneous:

Comment, Robert A. Jacobs, 34 New York Univ. Law Rev. 315	18
Installment Dealers' Reserves, Woolvin Patten and Brockman Adams, Taxes, The Tax Magazine, CCH, July, 1958, 485	18
House Resolution 4518	21

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OPINIONS BELOW

The findings of fact and memorandum opinion of the Tax Court are not officially reported, but appear in the record (Hansen R. 60-68). The opinion of the Court of Appeals for the Ninth Circuit (H.R. 86-94) is reported at 258 F.2d 585.

JURISDICTION

The judgment of the Court of Appeals was entered on August 4, 1958 (H.R. 95). Petition for writ of *certiorari* was filed on September 18, 1958, and was granted on November 10, 1958 (H.R. 96). The jurisdiction of this Court rests on 28 U.S.C. 1254.

QUESTION PRESENTED

Did finance fees withheld and controlled by General Motors Acceptance Corporation in a contingent liability

reserve, accrue as income to auto-dealer respondents in the year when the reserves were created by GMAC, or alternatively, in the year when released to respondents, if ever released at all?

STATUTES INVOLVED

Sections 22(a), 41, and 42(a) of the Internal Revenue Code of 1939 are printed in the Appendix to this brief, at pages 23-24. Printed in the Appendix to the brief for the Commissioner, at pages 61-70, are the following: Rev. Rul. 57-2, 1957-1 Cum. Bull. 17; Treasury Regulations 111, Sections 29.41-1 and 29.41-2; and G.C.M. 9571.

STATEMENT

Respondents are husband and wife, residing in a community-property state, where the husband is a Buick dealer engaged in the business of selling automobiles at retail (Alleged, H. R. 10; Admitted, H. R. 26).

Respondents sell new autos upon conditional sales contracts (Admitted, H. R. 26). All of respondents' sales of autos on credit in 1951, 1952 and 1953, the tax years at issue, were made upon the same GMAC form of conditional sales contract, and all were financed by General Motors Acceptance Corporation (Stipulated, R. 6). The form of contract used was admitted into evidence as Joint Exhibit 5-E, and appears in the record at H. R. 39-40.

In the sales on credit by dealer Hansen, no promissory note or other commercial paper was executed by the retail purchaser to secure the conditional sales contract. The testimony of respondent (H. R. 29-34) and of Dallas L. Carter, his Certified Public Accountant (H. R. 34-38), on direct and cross-examination, makes no

reference to any note or commercial paper other than the conditional sales contract. There was none. Express evidence of non-existence is absent from the record because reference to "paper made payable to the dealer" and to "the note issued to the dealer" first appeared in the Hansen case in the Brief for the Commissioner filed in this court (Pages 42 and 47 (footnote 20)).

The conditional sales contracts were payable by the retail purchaser at the office of General Motors Acceptance Corporation (Joint Exhibit 5-E (8), at H. R. 39). Respondents in fact held none of the conditional sales contracts for financing by respondents, and financed none of them through any finance company other than GMAC (Stipulated, H. R. 6; H. R. 29).

The pattern of respondents' financing of credit sales was consistent—a single, three-party transaction. In each instance the retail purchaser signed the conditional sales contract furnished by GMAC and payable at its office, on the same form (R. 6, Joint Exhibit 5-E at H. R. 39); respondents assigned to GMAC by the form for assignment on the face of the contract; and delivered it to GMAC in return for money (H. R. 6, 35, Joint Exhibit 5-E at H. R. 39).

The course of dealing between respondents and GMAC required that a contingent liability reserve, called "Dealer's Reserve," be withheld by GMAC out of the finance charges (H. R. 30, 31, 35, 36). The purpose of the reserve was to protect GMAC from losses (H. R. 31).

When a retail purchaser prepaid his contract to GMAC, part of the financing cost had to be refunded to

him (H. R. 31). Losses from prepayment and losses from abnormal depreciation before repossessions, were chargeable to the reserve (H. R. 31). Losses chargeable to contingent liability reserve did occur, in the years at issue, due to prepayments and due to abnormal or accelerated depreciation before repossession (H. R. 31).

The reserve was withheld and controlled completely by GMAC (H. R. 32). Respondents could not draw upon the contingent liability reserve at will; could not borrow against it; and had no right to any of the reserve until released by GMAC (H. R. 32, 38). The reserve withheld, in the three years at issue, was required to exceed five per cent of total outstanding conditional sales contract balances for respondents' retail purchasers, before any reserve could be released (H. R. 31). Only the excess over five per cent was released by GMAC, and not the five per cent withheld (H. R. 31).

Release of any reserve was contingent upon there being in the reserve an excess over five per cent of outstanding contracts (H. R. 31), at an annual date in January of February (H. R. 33), pursuant to GMAC's "Retail Plan" (H. R. 86).

Respondents could have held their own contracts, assuming they had sufficient cash and if they had their own contracts made up (H. R. 33). In fact they held none (Stipulated, H. R. 6(3)). They could have financed with some other finance company; if they had the connection; which they didn't (H. R. 34).

Respondents took the payments released to them by GMAC when they could get them, and took all they could get (H. R. 33). All payments received by respond-

ents from GMAC, including funds released from contingent liability reserve, were reported as income in the years in which received (H. R. 33, 36, 37).

Respondents' accounting system was upon the accrual basis (H. R. 36). The computations for a credit sale are indicated on Joint Exhibit 5-E (H. R. 39): The total down payment, if any, was subtracted from the cash sale delivered price. To this was added the cost of required car insurance and any other charges, the sum being the principal balance. The principal balance was added to the finance charge, to reach the time (deferred) balance on the contract, which was payable by the retail purchaser at the office of GMAC in specified installments (Joint Exhibit 5-E, at H. R. 39). The total time price paid by the retail purchaser was the sum of his total down payment and his time (deferred) balance.

When GMAC set up a contingent liability reserve on its books, respondents could not get it, and could not draw upon it at will (H. R. 32). On respondents' books a memorandum account called "Due Finance Companies" was debited, and another called "Reserve for Repossession" was credited (H. R. 36). These were never taken into or deducted from income (H. R. 87). Respondents did not accrue and return as income the GMAC reserves in the year of sale of the car—the year the reserves were established (H. R. 86). When GMAC released any amount to respondents from the reserve, it was picked up in his income (H. R. 33, 36, 37, 87). The accountant for respondents testified that the described method of accounting treatment "is a generally accepted method of accounting which properly allocates the

income to the year in which it was earned, and I think it meets all the requirements of good accounting" (H. R. 36, 37).

Bad checks were charged off on respondents' books in connection with sales on open account of parts, accessories and repairs; but had nothing to do with the financing of sales of autos (H. R. 32, 37). No losses on GMAC reserves were charged to this account (H. R. 32, 37, 87).

Respondents followed a regular and consistent theory of accounting in 1951, 1952, and 1953, excepting only that all contingent liability reserves created by GMAC in 1952 were picked up as income in 1952 (H. R. 35). Refund was claimed (H. R. 9) and no estoppel has been asserted at any stage in this case.

The Commissioner determined deficiencies in income tax for respondents in 1951, 1952 and 1953, and certain civil penalties. After exhaustion of the procedure for administrative review, respondents filed Petition for Redetermination of Deficiency with the Tax Court of the United States, which entered decision upholding the Commissioner on August 1, 1957.

Upon petition for review, the United States Court of Appeals for the Ninth Circuit unanimously reversed the Tax Court, upon the contingent liability reserve issue, on August 4, 1958 (H. R. 86-95), by opinion reported at 258 F.2d 585. It affirmed upon a penalty issue not before this court.

SUMMARY OF ARGUMENT

Respondents' method of accounting clearly reflected income for tax purposes. Net income is computed in accordance with the method of accounting regularly employed in keeping the books of the taxpayer, unless the method employed does not clearly reflect the income. Int. Rev. Code (1939) sec. 41; Treas. Reg. 111, sec. 29.41-1, sec. 29.41-2. An accrual basis taxpayer must record income, and pay tax thereon, upon fixation of the right to receive income. *Spring City Foundry Co. v. Commissioner,* 292 U.S. 182, 184, 185. *North American Oil Consolidated v. Burnet,* 286 U.S. 417, 423-424. Respondents were upon the accrual basis.

Respondents accrued and declared reserve as income when their right to it became fixed—upon release and first availability to respondents.

There was no fixation of right to receive reserve for respondents, at date of sale of an auto. The reserve was an entry of unearned income on GMAC's books. Respondents had no legally enforceable right. GMAC held and controlled it. The reserve was subject to unilateral depletion by GMAC, to offset repossession losses and prepayment refunds. Only the excess over five per cent of outstanding contract balances for respondents' customers, if any excess, was available to the dealer, and that only once a year. The reserve was a contingent credit, not includible as income, like the patronage refund credit in *Long Poultry Farms, Inc. v. Commissioner,* 249 F.2d 726 (C.A. 4).

Actual receipt of income is not in issue, because respondents declared all they actually received when re-

ceived. There was no constructive receipt of income; because the concept of constructive receipt pertains to cash basis rather than to accrual basis, *Hansen v. Commissioner*, 258 F.2d 585, 587 (C. A. 9) (H. R. 86, 88); and because constructive receipt requires availability to the recipient so that it may be drawn upon at any time, and requires control and disposition of receipt, by the recipient. Treas. Reg. 118, sec. 39.42-2. Respondents had no control until release of the reserve. It was unavailable.

Respondents at no time acquired any account receivable in their own favor from the retail auto-purchaser. Aside from down payment (not in issue), the purchaser's only obligation was to GMAC. This is the significance of the single three-party transaction. By the single conditional sales contract (Joint Exhibit 5-E, H. R. 39-40), the dealer-respondents sold an auto; GMAC sold credit; and the retail purchaser bought both—by making a down payment to dealer and by contracting to make installment payments to GMAC. The installments included the finance charges from which the reserve was earned, month by month, over the term of the conditional sales contract. Purchasers' installments were payable at GMAC's office. The only consideration to dealer in the entire transaction (aside from the down payment not in issue) was from GMAC.

Petitioner's theory is "the two-transaction hypothesis," set forth at pages 41-52 of his brief. It does not fit the facts of the *Hansen* case, in reality or in substance. Circuit Judge Barnes, for the court below, called the theory of two separate sales "totally unrealistic" and

"an artificial characterization of the transaction * * *." *Hansen v. Commissioner*, 258 F.2d 585, 588 (C. A. 9) (H. R. 86, 89). GMAC was a necessary and patent party to every auto sale on credit by respondents, from the beginning of each sale. This was the factual reality, the substance, of each sale on credit.

Case authority directly in point strongly supports the unanimous decision below, in favor of respondents on the reserve question. The United States Courts of Appeals have held for the auto-dealer-taxpayer in each case where the facts established a single three-party transaction: *Hansen v. Commissioner*, 258 F.2d 585 (C. A. 9) cert. granted Nov. 10, 1958, No. 380, Oct. Term, 1958; *Glover v. Commissioner*, 253 F.2d 735 (C.A. 8) cert. granted Nov. 10, 1958, No. 381, Oct. Term, 1958; *Blaine Johnson v. Commissioner*, 233 F.2d 952 (C.A. 4); *Texas Trailercoach, Inc. v. Commissioner*, 252 F.2d 395 (C.A. 5); *West Pontiac, Inc. v. Commissioner*, 257 F.2d 810 (C.A. 5). Courts of Appeal decided in favor of the Commissioner in two cases where the facts were held to establish separate sales of auto and of account receivable. *Baird v. Commissioner*, 256 F.2d 918 (C.A. 7) cert. granted Nov. 12, 1958, No. 512, Oct. Term, 1958; *Schaeffer v. Commissioner*, 258 F.2d 861 (C.A. 6). Other citations to cases and to the periodical literature appear in respondents' main argument.

Petitioner errs in argument that reserves are taxable at creation because respondents ultimately would receive payments "either in cash or in the offset of their obligations to the finance companies" (Br. for Com. 32; 27). The "obligations" are contingent liabilities, not

presently in existence. Does the avoidance of a contingent liability, not yet incurred or fixed as a liability, constitute taxable income?

Petitioner argues the "re-enactment doctrine" at pages 23 and 39 of his brief. This point was never raised below, in the *Hansen* case, on the reserve issue; although it was raised on a civil penalty issue not before this court. Petitioner should be confined to points previously raised upon the issue at bar, in attacking the judgment below, upon *certiorari*.

ARGUMENT

I.

Respondents' Method of Accounting Clearly Reflected Income for Tax Purposes

A. The Method and the Issue

Respondents' regular method of accounting was to accrue and declare as income any payment they could get from GMAC's reserve, as soon as respondents could get it, but not before. Respondents accrued reserve into income—not when entries were set up on GMAC books at sale of car—but when excess of reserve over a required minimum, if any, was released and made available to respondents.

The issue is whether this method of accounting accurately reflected income for tax purposes. Did respondents have such a right to an unpaid sum as to require accrual of it as income when the car was sold and GMAC set up its entries?

B. The Statute

The Internal Revenue Code of 1939 governs computation of net income and of gross income:

"SEC. 41. GENERAL RULE.

"The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *." (26 U.S.C. 1952 ed., Sec. 41.)

"SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

"(a) General Rule.—The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *." (26 U.S.C. 1952 ed., Sec. 42.)

C. The Accounting Principle — Income Accrues Upon Fixation of Right to Receive

Two United States Supreme Court opinions, many years ago, established the basic tests which an accrual accounting system must pass in order clearly to reflect income. The case of *North American Oil Consolidated v. Commissioner*, 286 U.S. 417, 424, established the concept of income being reportable when the taxpayer receives earnings under a "claim of right":

"The net profits were not taxable to the company

as income of 1916. For the company was not required in 1916 to report as income an amount which it might never receive. * * * There was no constructive receipt of the profits by the company in that year, because at no time during the year was there a right in the company to demand that the receiver pay over the money. * * * Nor is it material, for the purposes of this case, whether the company's return was filed on the cash receipts and disbursements basis, or on the accrual basis. In neither event was it taxable in 1916 on account of income which it had not yet received and which it might never receive." *North American Oil Consolidated v. Commissioner,* 286 U.S. 417, 423-4.

This court has established that an accrual basis taxpayer must record income, and pay tax thereon, upon fixation of the right to receive income:

"Keeping accounts and making returns on the accrual basis, as distinguished from the cash basis, import that it is right to receive and not the actual receipt that determines the inclusion of the amount in gross income. When the right to receive an amount becomes fixed, the right accrued." *Spring City Foundry Co. v. Commissioner,* 292 U.S. 182, 184.

D. Respondents Had No Fixed Right and No Claim of Right to Receive Reserve Until GMAC Released It

The plain fact is that the respondents had no fixed right and no claim of right—legal, contractual, or otherwise—to receive reserve until GMAC decided to release it. There could be no payment to petitioners at all unless the reserve exceeded 5 per cent of total outstanding contracts financed for petitioners; and then payment was limited to the excess, without invasion of the 5 per cent

reserved which the Commissioner would allocate to income.

There were substantial, concrete, restrictive conditions precedent. Any payment to petitioners was contingent upon an excess, which could result only if GMAC had favorable experience in collections upon the contracts from customers of petitioners. Favorable experience was uncertain, because losses from prepayments by auto purchasers were chargeable to the reserve, as were losses for abnormal depreciation before repossession. The testimony establishes that there always were such losses. Because of losses to be charged to the reserve, the ultimate receipts from it by petitioners were not determinable at the dates of creation of reserve.

As the court below pointed out:

> "The amount credited to the dealer's reserve is completely controlled by GMAC. It is true an amount is fixed, but this amount is subject to unilateral depletion by GMAC to offset repossession losses, prepayment refunds, and other charges determined by GMAC; the possibility of payment under this circumstance, although the maximum amount is determined, is so remote and contingent that it cannot be said to have become fixed and ascertained (*cf. Long Poultry Farms v. Comm'r*, 4 Cir., 1957, 249 F.2d 726, acquiesced in by the Commissioner, Rev. Rul. 57-358, 1958 P-H para. 54-503)." *Hansen v. Commissioner*, 258 F.2d 585, 589 (C.A. 9) H. R. 86, 90.

The record shows that respondents declared all actual receipt of income when received. That is undisputed. All payments by retail purchasers were made to GMAC,

and all payments made to respondents by GMAC were taken up and declared as received.

E. Respondents Had No Constructive Receipt

Respondents had no constructive receipt of the funds withheld in reserve by GMAC. As Circuit Judge Barnes, speaking for the Ninth Circuit, lucidly pointed out below:

> "Certain principles are appropriate for review. A cash basis taxpayer records income upon actual or constructive receipt—and it is well to note that constructive receipt means that the taxpayer has the present right to receive funds which he, for his own reasons, chooses not to exercise (Treas. Reg. 118, s. 39.42-2). An accrual basis taxpayer must record income, and pay tax thereon, upon fixation of the right to receive income, not upon its actual or constructive receipt." *Hansen v. Commissioner,* 258 F.2d 585 (C.A. 9) H. R. 86, 88.

Even if an accrual basis taxpayer had constructive receipt, respondents had none from the reserves while withheld. Treasury Reg. 118, sec. 39.42-2, sets forth the doctrine of constructive receipt. It provides that income may be taxed prior to the year of actual receipt although not then actually reduced to possession, if: (1) it is credited to the account or set apart for the taxpayer, and (2) it may be drawn upon by the taxpayer at any time.

> "To constitute receipt in such a case the income must be credited or set apart to the taxpayer without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made, and must be available to him so that it may be drawn at any time, and its

receipt brought within his own control and disposition * * * " Treas. Reg. 118, s. 39.42-2.

F. Each Sale of An Auto on Credit Was a Single Three-Party Transaction, to Which GMAC Was a Necessary Party

In substance the sale of an auto on credit was and had to be a single three-party transaction. Petitioners sold an auto, for trade-in and cash. GMAC sold the use of its money, for a finance charge. The purchaser bought both —the auto from the dealer, and the credit from the finance company. The finance charge was GMAC's price for the use of its money.

There had to be a finance company in each transaction, because the purchaser was unable to pay cash for the car. GMAC was a necessary party to every sale of an auto on credit. The absence of contractual requirement to finance sales through GMAC is immaterial, where practical business necessity caused every credit sale to be so financed.

The Sixth Circuit has said, in a different application:

> "And without regard to whether the result is imposition or relief from taxation, the courts have recognized that where the essential nature of a transaction is the acquisition of property, it will be viewed as a whole, and closely related steps will not be separated either at the instance of the taxpayer or the taxing authority." *Commissioner v. Ashland Oil & Refining Co.*, 99 F.2d 588, 591 (C.A. 6), cert. denied April 17, 1939.

In a different application, in *Helvering v. New Haven & Shore Line Ry. Co., Inc.*, 121 F.2d 985, 988, cert. denied Feb. 9, 1942, the Second Circuit said:

"As for the effort of the Commissioner to atomize the plan, as it were, *i.e.*, to separate it into its several steps and treat the last as though it stood alone, it has been repeatedly repudiated."

G. Retail Purchaser Incurred No Account Payable to Respondents: Respondents Acquired No Account Receivable

The single three-party transaction met practical business necessity by affording an ample and reliable source of credit. Its primary significance in the tax question before the court, however, is this: In each single three-party sale on credit, the retail purchaser's only obligation to pay, after his down payment not in issue, was an obligation to GMAC. The purchaser had to make his installment payments at the office of GMAC. Common sense dictates that the payments at GMAC's office were payments to GMAC, and nothing in the record indicates otherwise. Respondents at no time owned any account receivable from the retail auto-purchaser. The only consideration to respondents, aside from the original down payment not in issue, was from GMAC.

II.

Authority Strongly Supports the Unanimous Decision in Favor of Respondents Below

Case authority directly in point strongly supports the unanimous decision below, in favor of respondents on the reserve question. The United States Courts of Appeals have held for the auto-dealer-taxpayer in each case where the facts established a single three-party transaction. *Hansen v. Commissioner*, 258 F.2d 585 (C.A. 9) cert. granted Nov. 10, 1958, No. 380, Oct.

Term, 1958; *Glover v. Commissioner*, 253 F.2d 735 (C.A. 8), cert. granted Nov. 10, 1958, No. 381, Oct. Term, 1958; *Blaine Johnson v. Commissioner*, 233 F.2d 952 (C.A. 4); *Texas Trailercoach, Inc., v. Commissioner*, 251 F.2d 395 (C.A. 5); *West Pontiac, Inc., v. Commissioner*, 257 F.2d 810 (C.A. 5). Respondents will not belabor the Court with lengthy quotations from the decisions cited above, but will point out that the operative facts fit the present case and that the collective wisdom of the Courts of Appeals supports respondents herein. Two other decisions are distinguished here below.

Courts of Appeal decided in favor of the Commissioner in two cases where the facts were held to establish separate sales of auto and of account receivable. *Baird v. Commissioner*, 256 F.2d 918 (C.A. 7), cert. granted Nov. 12, 1958, No. 512, Oct. Term, 1958; *Schaeffer v. Commissioner*, 258 F.2d 861 (C.A. 6). In the *Baird* case it was stipulated that, in connection with the sale of trailers under conditional sales contracts, "the purchaser executed a note payable to the partnership for the unpaid price of the trailer, plus insurance, interest and financing charges" (Baird Record, 15). There was no promissory note in the Hansen case, and no instruments payable to the dealer. In *Baird* the Court of Appeals pointed out that "the partnership sold to either of two finance companies or a bank unpaid notes, chattel mortgages and conditional sales contracts." *Baird v. Commissioner*, 256 F.2d 918, 920 (C.A. 7); and again in footnote 9 at page 923, that no delinquencies were charged to the dealer's reserve accounts by any finance company, for the relevant years. Respondents Hansen, in the present case, uniformly dealt

with one finance company which was an original party to each sale on credit. Respondent Hansen sold no paper external to the conditional sales contract; upon the conditional sales contract, GMAC was in practical operation the payee. Losses were charged to the dealer's reserve in the Hansen case.

In the *Schaeffer* case, again the court found two separate transactions. By sale of car to purchaser, for a note and contract, dealer acquired an asset in the nature of an account receivable, without contingency. As between dealer and purchaser, the entire amount of the contract obligation accrued to dealer. *Schaeffer v. Commissioner,* 258 F.2d 861, 865 (C.A. 6). These facts differ from those in the case at bar.

An article supports respondents' position with penetrating analysis. *Installment Dealers' Reserves,* Woolvin Patten and Brockman Adams, Taxes, The Tax Magazine, CCH, July, 1958, pp. 485-490, 532. A scholarly Comment by Robert A. Jacobs concludes: "Inasmuch as the dealer has employed accounting procedures which properly reflect income and has reported as income those amounts to which the right to receive has become fixed, there is no reason why the Supreme Court should overturn the holding of the Ninth Circuit." 34 New York Univ. Law Rev. 315, 323.

The reserve issue was decided in favor of taxpayer in *Keasbey & Mattison Co. v. United States,* 141 F.2d 163 (C.A. 3). Taxpayer was a manufacturer of asbestos products who arranged with a finance company to discount notes given by purchasers to retailers of its products. Under its contract with the finance company the

taxpayer guaranteed part of the notes. Part of the discount was to be retained by the finance company in a reserve account analogous to GMAC's reserve, to cover the guaranty. The Court unanimously held that the amount of the reserve was not income to the taxpayer so long as the right to any of it was uncertain. An issue similar in principle was decided in favor of taxpayer, in *Commissioner v. Cleveland Trinity Paving Co.*, 62 F.2d 85 (C.A. 6). The court held that under a paving contract, percentages retained to guarantee maintenance of pavement were taxable as income to the contractor in the years when the money was paid, rather than in the years when the contracts were completed except as to maintenance. The court noted "the further principle that the fact that the taxpayer kept its books in most respects upon the accrual basis does not require it to accrue that which is but contingently earned." *Commissioner v. Cleveland Trinity Paving Co.*, 62 F.2d 85 (C.A. 6). The Commissioner did not appeal.

III.

Basic Fallacies Appear in Petitioner's Argument

A. Avoidance of a Contingent Liabilty Does Not Constitute Income

Petitioner errs in argument that reserves are taxable at creation because respondents ultimately would receive payments "either in cash or in the offset of their obligations to the finance companies." (Br. for Com. 32; 27). The "obligations" are contingent liabilities, not presently in existence. Does the avoidance of a contingent liability, not yet incurred or fixed as a liability, constitute taxable income? No. If A guarantees or warrants

that B will pay C, and B pays C, has A received taxable income? Of course not.

B. All Cases Cannot Be Equated, But Must Be Decided Upon Their Facts

Petitioner's brief for the Commissioner is a consolidated brief. It argues three cases jointly; including one not consolidated for trial, *Baird v. Commissioner,* 256 F.2d 918 (C.A. 7), No. 512, Oct. Term, 1958, in which one the Commissioner appears as respondent and not as petitioner. Partly as a result, there is a recurrent attempt to equate the operative facts of all three cases. The rationale is that if the sale on credit in one case was two transactions (sale of a car and sale of commercial paper by dealer), the sale on credit in the other two cases must be two transactions as well. Petitioner's "two-transaction hypothesis" is set forth at pages 41-52 of his brief. It does not fit the facts of the *Hansen* case, in reality or in substance. Circuit Judge Barnes, for the court below, called the theory of two separate sales "totally unrealistic" and "an artificial characterization of the transaction * * *." *Hansen v. Commissioner,* 258 F.2d 585, 588 (C.A. 9) (H.R. 86, 89). GMAC was a necessary and patent party to every auto sale on credit by respondents, from the beginning of each such sale. This was the factual reality, the substance, of each sale on credit. The dealer's reserve cases cannot be equated, but must be decided in distinct categories set by the facts of the cases.

C. The "Re-Enactment Doctrine" Is a New Point Not Properly Before This Court

Petitioner argues the "re-enactment doctrine" at

pages 23-24 and 39 of his brief. This point was never raised below, in the present case, on the reserve issue; although it was raised on a civil penalty issue not before this Court. Petitioner should be confined to points previously raised upon the issue at bar, in attacking the judgment below, upon certiorari. In the petition for a writ of certiorari in the present case, there is not a word about the "re-enactment document." On certiorari to review a decision of the Court of Appeals, matters not relied upon as basis for the petition will not be considered. *Alice State Bank v. Houston Pasture Co.*, 247 U.S. 240.

If the Court should find the point to be properly before the Court—and respondents do not waive the objection—respondents would attack its probative effect, in the light of facts including economic development in industries affected; and would attack the weakness of the inference of legislative intent; and would argue that administrative practice as inferentially approved by Congress is approved (if at all) as qualified by ruling case law at the time; and respondents would cite pending House Resolution 4518 as expressive of legislative intent. But the point is not properly before the Court.

D. The Tax Court Rule: Commissioner's Practice

Petitioner's brief, at page 29, cites some twenty decisions of the Tax Court in favor of the Commissioner. As properly indicated, five have been reversed, three have been affirmed, and three are pending on appeal. Respondents admit that the Tax Court uniformly upholds the Commissioner in the contingent liability cases. Dealers have won reversals in the Fourth, Fifth, Eighth

and Ninth Circuits, but the Tax Court has yet to decide the reserve issue in favor of a dealer, excepting in 1941 in the case of *Ernest G. Beaudry,* 1941 P-H B.T.A. Memorandum Decisions, par. 41, 114. The Commissioner has declined to acquiesce. Rev. Rul. 57-2, 1957-1 Cum. Bull. 17.

This works injustice, because only the taxpayer who can pay the expense of appeal can prevail, and he only at considerable expense.

The Commissioner's position on the dealer reserve question, as set forth clearly in Rev. Rul. 57-2, 1957-1 Cum. Bull. 17, and in G.C.M. 9571, X-2 Cum. Bull. 153 (Brief for Com. 65-70), is based upon a two-sale concept which does not fit the facts of the present case.

CONCLUSION

For the reasons stated it is respectfully submitted that the judgment of the court below should be affirmed.

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APPENDIX

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) General Definition.—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits, and income derived from any source whatever. * * *

* * * * *

(26 U.S.C. 1952 ed., Sec. 22.)

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

(26 U.S.C. 1952 ed., Sec. 41.)

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

(a) General Rule.—The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *

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(26 U.S.C. 1952 ed., Sec. 42.)